



Australian Government

International Air Services Commission

DETERMINATIONS

Determinations: [2010] IASC 107, [2010] IASC 108, and [2010] IASC 109
The Route: Indonesia
The Applicants: Qantas Airways Limited (ACN 009 661 901) (Qantas)
Strategic Airlines Pty Ltd (ACN 059 547 723) (Strategic Airlines)
Virgin Blue Airlines Pty Ltd (ACN 090 670 965) (Virgin Blue)
Public Register File: IASC/APP/201012

1 The applications

1.1 On 27 July 2010, Qantas applied for an allocation of 3,898 seats of capacity per week on the Indonesia route, and an allocation of 729 seats and four frequencies of beyond Indonesia capacity. Qantas' wholly-owned subsidiary company, Jetstar Airways (Jetstar) plans to introduce additional services between Australia and Indonesia from December 2010. Qantas proposes to use the capacity sought to operate an extra 19 services per week. Fifteen of these would service Perth, with 10 of the 15 to Denpasar. The other five would go to Jakarta, with these services extending on to Singapore. The other four services are planned to operate to Denpasar from Melbourne. The services would be operated using one-class A320 aircraft and two-class A330 aircraft. Jetstar plans to commence 17 of the 19 services from 31 March 2011. Two Denpasar – Melbourne services would not be introduced until 31 October 2011. The capacity is proposed to be fully utilised by 31 October 2011.

1.2 In response to Qantas' application, the Commission published a notice on 27 July 2010 inviting other applications for the capacity sought by Qantas. In response to this notice, on 28 July 2010, Strategic Airlines Pty Ltd (Strategic Airlines) applied for an allocation of 1,716 seats on the Indonesia route. It plans to add 11 weekly A320-200 services with 156 seats (12 business, 144 economy seats). Strategic Airlines proposes four extra services from Perth complementing its existing three flights per week, with the remaining seven frequencies divided between Sydney and Melbourne. Strategic Airlines stated that it would begin introducing these services in December 2010, with capacity to be fully utilised by the end of October 2011.

1.3 On 5 August 2010, Pacific Blue Airlines (Aust) sought an allocation of 2,340 seats to enable it to operate an extra 13 services per week utilising 180 seat B737-800 aircraft. It plans to fully use the capacity by 31 October 2011. The main expansion is from Perth, with seven services per week planned. Both Sydney and Brisbane would receive an extra three weekly flights. Pacific Blue Australia currently operates 25

services per week – daily services from each of Brisbane, Perth and Melbourne, plus four services per week from Sydney. All services operate to Denpasar.

1.4 Subsequent to this application, the Virgin Blue Group asked the Commission to consider its application for capacity be made by Virgin Blue Airlines. The Commission agrees to do so. Concurrently, the Virgin Blue Group requested a transfer of all capacity under its determinations on the Indonesia route from Pacific Blue Australia to Virgin Blue Airlines. Both carriers are wholly-owned subsidiaries of Virgin Blue Holdings. The Commission authorised the capacity transfers and issued Decision IASC [2010] 206.

1.5 As the applications from Strategic Airlines and Pacific Blue Australia created competing applications for the same available capacity, the Commission wrote on 9 August 2010 to Qantas, Strategic Airlines and Pacific Blue Australia inviting them to address the paragraph 5 criteria in the Minister’s policy statement in support of their respective applications.

1.6 On 19 August 2010, the three airlines responded to the Commission’s request to address the paragraph 5 criteria. These supporting submissions are summarised in Section 5 below. The Pacific Blue Australia submission included a confidential attachment. The confidentiality issues were matters of a commercial nature and other possibly sensitive issues.

1.7 Following receipt of the paragraph 5 responses from the airlines, the Commission published a notice on 19 August 2010 inviting submissions about the three applications. The Victorian Government provided a submission dated 25 August 2010. On 30 August 2010 a submission was received from the Flight Attendants Association of Australia. On 1 September 2010, a confidential submission was received from the Department of Infrastructure, Transport, Regional Development and Local Government (now the Department of Infrastructure and Transport).

1.8 All public material supplied by the applicants is filed on the Register of Public Documents. Commercial-in-confidence material provided by the applicants and the Department is filed on the Commission’s Confidential Register.

2 Current services

2.1 The Indonesia route is served by the following Australian airlines:

Qantas

2.2 The Qantas Group currently operate 23 services per week on the Indonesia route, most of which are operated by Jetstar. The Group currently operates four frequencies Melbourne – Denpasar, six services Sydney – Denpasar, four services Sydney – Jakarta, daily services Perth – Denpasar, and two services Perth – Jakarta. Using its beyond capacity, Jetstar is currently operating two services per week from Perth to Jakarta and beyond to Singapore, and four weekly services from Perth to Denpasar and beyond to Singapore.

2.3 Qantas also code shares on Jetstar's service through a free-sale code share arrangement.

Strategic Airlines

2.4 Strategic Airlines began services on the Indonesia route in mid-2010 with three services per week between Perth and Denpasar. Strategic has added a once weekly service between Port Hedland and Denpasar, providing a domestic connection from Brisbane to these flights. Strategic has an allocation of unlimited capacity from the small Australian gateway airports, which it uses to operate its Port Hedland to Denpasar service.

Pacific Blue Australia

2.5 On the main Australian gateway airports, Pacific Blue Australia currently operates 25 services per week using B737-800 aircraft. Of these 25 services, Pacific Blue Australia daily services fly from Brisbane, Perth and Melbourne. The airline also operates four services per week from Sydney to Denpasar.

3 Provisions of relevant air services arrangements

3.1 The air services arrangements between Australia and Indonesia permit multiple designation of airlines. The designated airlines of Australia may determine the frequency of service and aircraft type subject to capacity entitlements totalling 14,800 seats per week in each direction on the specified routes to and from Sydney, Melbourne (including Avalon), Brisbane and Perth. An additional 150 seats per week are available under the spill-over provisions of the air services arrangements. These seats are not available for allocation by the Commission but are subject to approvals by the aeronautical authorities. Passenger operations are unrestricted to and from all points in Australia other than, Sydney, Melbourne (including Avalon), Brisbane and Perth.

3.2 The Commission has previously allocated 10,800 seats per week to Australian carriers as follows: Qantas, 5892 seats per week; Strategic Airlines, 408 seats per week (with 60 seats approved under the spill-over provisions of the air services arrangements); and Pacific Blue Australia, 4,500 seats per week. The Register of Available Capacity shows that there are 4,000 seats per week remaining available for allocation to Australian airlines for services to and from Sydney, Melbourne (including Avalon), Brisbane and Perth.

3.3 The Register of Available Capacity shows that 13 frequencies per week utilising up to 4,861 seats weekly beyond Jakarta, and two points in Indonesia west of Denpasar to Singapore, points in Malaysia and a point in Thailand of passenger capacity are available for allocation. All capacity available for services beyond Denpasar has been allocated to Qantas and Pacific Blue Australia.

Singapore

3.4 Under the Australia - Singapore air services arrangements, Australian carriers are entitled to operate between Australia and Singapore via intermediate points in Indonesia.

4 Characteristics of the Australia – Indonesia route

4.1 Year ending June 2010, Indonesia was number four for the top 20 international destinations experiencing an annual growth of 42.2 %. Of the top 20 origin/destination markets, growth in short-term visitor arrivals was highest from Indonesia at 23.6%.

4.2 As the table below shows, in the year ending June 2010, traffic on the Australia – Indonesia route totalled just over 1,355,300 passenger movements. Traffic growth over the previous year was 41.2%. The average annual growth rate from 2007 to 2010 was 22.4%.

4.3 Of the total movements, 93% of passengers travelling on the route had a destination of Australia or Indonesia. The majority of these passengers (1,355,356 for the June 2010 year) flew on direct services with only 16,858 passengers travelling via intermediate points. The remaining 6.9% of passengers travelling on the route (just over 115,000) were destined for countries beyond Indonesia or Australia (such as Singapore or New Zealand).

	Australia – Indonesia Air Passenger Market					Compound Annual growth rate 06-10	
	Years ended June						
	2006	2007	2008	2009	2010		
Direct (Annual % change)	541,448	500,884	687,415	900,097	1,355,356	81.8%	25.8%
		-7.5%	37.2%	30.9%	50.6%		
Indirect (Annual % change)	135,158	147,432	170,335	183,520	185,828	11.2%	8.3%
		9.1%	15.5%	7.7%	1.3%		
Through (Annual % change)	61,347	65,931	86,593	89,305	115,108	6.9%	17.0%
		7.5%	31.3%	3.1%	28.9%		
Total Market (Annual % change)	737,953	714,246	944,344	1,172,922	1,656,292	100.0%	22.4%
		-3.2%	32.2%	24.2%	41.2%		

Source and note: Data in this table has been derived from information supplied by the Australian Bureau of Statistics. Figures may not add to totals due to rounding.

4.4 Australian residents dominate travel number on the route, comprising about 83% of traffic with an origin/destination of Australia or Indonesia. This proportion has risen sharply over recent years, with over 1 million Australian's visiting Indonesia in the

year ending June 2010. This compares with just over 250,000 visitors to Australia originating from Indonesia.

4.5 Nearly 84% of Australian residents travel to Indonesia for holidays, with about 6% visiting relatives. The smaller Indonesia visitor market is made up of about 43% coming to Australia for a holiday followed by 17% visiting relatives. Eleven per cent of visitors from Indonesia travel to Australia for educational reasons.

5 Summary of applicants' claims against the paragraph 5 criteria

5.1 The claims of Qantas, Strategic Airlines, and Virgin Blue against the paragraph 5 criteria are set out below.

Introduction

Qantas

5.2 Qantas provided introductory information about the Australia – Indonesia passenger market from the Australia Bureau of Statistics, as well as outlining Jetstar's plans for the route.

5.3 Qantas notes passenger shares on the Australia-Indonesia route are primarily divided between Garuda Indonesia, Pacific Blue Airlines and the Qantas Group. Qantas has placed market shares on the route as follows, Garuda Indonesia at 31%, the Qantas Group at 29% (Jetstar, 23% and Qantas 6%), Pacific Blue Airlines at 17%, Indonesia AirAsia at 11% and Singapore Airlines at 8%.

5.4 Jetstar commenced services to Indonesia in 2006, operating a total of four flights per week from Sydney and Melbourne to Denpasar. Since then, Jetstar has increased its services to Indonesia in 2008 when it took over most of Qantas' Indonesia flights.

5.5 Qantas submits that if it is successful in its application for 26 % of the total Australian third-fourth capacity entitlement, Jetstar would significantly increase its capacity offering to Indonesia.

5.6 Jetstar notes it is seeking to grow its operations on the Perth – Denpasar sector, its growth has however been constrained by the lack of available capacity. Jetstar notes however, that the growth from Indonesian competition has grown. Jetstar is also seeking to close the frequency gap relative to its largest competitor, Indonesia AirAsia, which launched daily Perth – Denpasar services in August 2009.

5.7 On the Perth – Jakarta route, the Qantas Group notes Qantas and Jetstar are the only Australian carriers to operate services between Australia and Jakarta. Jetstar is seeking to accommodate the growth in demand on the route. Jetstar is the only airline serving the Perth – Jakarta market, since Garuda Indonesia ceased operating its four weekly services in May 2009.

5.8 Jetstar's proposed schedule is focused on servicing and growing point-to-point traffic. Jetstar's proposed growth in services would also offer same-day connectivity to over 25 cities, including four in New Zealand. Jetstar's network includes convenient connections to major ports, as well as regional ports, via Qantas services.

Strategic Airlines

5.9 Strategic Airlines notes that it is the new entrant within this sector. It states that there is little doubt that the competition benefits, enhanced tourism offering, consumer choice and trade benefits that are created by Strategic Airlines presence are clearly an asset to this sector's industry structure.

5.10 Strategic proposes to operate daily services between Perth – Denpasar allowing passengers to travel on a full service Australian airline, every day of the week, in the high demand market of Perth. Strategic also submits that the remaining capacity will be divided between services from Brisbane and Melbourne to Denpasar, introducing a full service Australian carrier to the route where there is currently none operating.

5.11 Strategic Airlines proven ability to grow the aviation market segment in question provides benefits to both consumers and the nation's trade alike.

5.12 Strategic Airlines notes its current allocation of capacity on the Indonesia route represents approximately 4% of the capacity available to all Australian carriers. Strategic Airlines submits that given the current allocation of seats among incumbent operators, it believes that its request is both fair and equitable, particularly given its full-service offering and the provision of a business class to the market which, Strategic Airlines notes, are both currently lacking in the offerings provided by the Australian incumbents.

Virgin Blue Group

5.13 Pacific Blue Australia, submits that the Virgin Blue Group has made a significant investment in the Indonesia market and operates 28 weekly services between points in Australia and points in Denpasar, noting that the Group intends to grow its presence in the market.

5.14 Since the entry of Pacific Blue Australia in the market there has been a significant and positive change in the competitive environment for the provision of international air services and genuine and transparent competition between Australian carriers and with foreign carriers serving the market.

5.15 Pacific Blue Australia submits that increasing its capacity will maintain the competitive environment established by the Virgin Blue Group and ensure direct and transparent competition.

Competition benefits

Qantas

5.16 Jetstar submits that it is committed to offering sustainable low and competitively priced fares on the Australia Indonesia route. Jetstar considers that its low air fares have significantly influenced the high growth rate of travel between the two countries, due to increase affordability and choice, and its pricing strategy has concurrently contributed to creating a competitive environment between all airline operators to provide affordable air travel between Australia and Indonesia.

5.17 Jetstar considers that further traffic rights would enable Jetstar to offer a greater number of low fares to the rapidly growing market.

5.18 Jetstar submits that its plans to introduce additional services between Australia and Indonesia would offer consumers increased choice and frequency of service. Jetstar notes it is currently the only Australian carrier to offer Perth-Jakarta services and additional capacity would allow an increase in services from twice weekly to a daily frequency.

5.19 Qantas expressed its surprise at Strategic Airlines, which it notes has been a small local player, suddenly having the capability to undertake such a large increase in its services.

Strategic Airlines

5.20 Strategic Airlines note that it commenced operations over the Perth – Denpasar sector on 12 June 2010 with sales commencing on 16 March 2010.

5.21 Strategic Airlines submits that the increased capacity sought by Strategic Airlines will drive increased demand for travel to Bali, and augur well for competition across all Australian gateway ports. Strategic Airlines further submits that if the capacity sought by Strategic Airlines is received in its entirety, Strategic Airlines will be able to commence an additional 11 return services each week. Strategic Airlines notes its plans to increase its current service from three services each week to a daily service from Perth, allowing passengers the opportunity to travel on a full-service Australian airline every day of the week in the high-demand market of Perth. Strategic Airlines further notes that it is anticipated all of these additional services ex Perth will be offered by 31 March 2011 and operated by 30 June 2011.

5.22 Strategic Airlines submits that if it receives the allocation requested, the remaining capacity will be dedicated to the provision of direct services from Brisbane and Melbourne to Denpasar, as early as 30 June 2011, but prior to 31 October 2011. In this regard, Strategic Airlines submit that these new services will provide much needed travel options for passengers out of these gateway ports, and will again introduce a full-service Australian carrier to the route where there is currently none operating.

Virgin Blue Group

5.23 Pacific Blue Australia notes the requirement that Australian carriers be able to compete effectively with one another and with carriers of foreign countries was met with its entry to the Indonesia market in November 2008.

5.24 Pacific Blue Australia further submits that since its entry into the market, tariffs have lowered, demand has been significantly stimulated with commensurate increases in consumer choice and welfare benefits derived from direct and transparent competition with incumbent carriers. Pacific Blue Australia submits that ensuring it maintains its relative position in the market will assist measurably the prospects of maintaining lower tariffs, increased choice and frequency and product differentiation.

Other benefits

Tourism benefits

Qantas

5.25 Jetstar believes its planned additional services on a number of Australia-Indonesia sectors will encourage more visitors to Australia. Qantas has submitted that it believes Australian tourism will benefit from its expanding interline network as the region becomes more accessible, and more attractive to the northern hemisphere.

5.26 Jetstar will promote the additional Indonesia services on an ongoing basis via network-wide and tactical route-specific campaigns.

5.27 Jetstar notes it offers holiday packages to visitors travelling to Australia to suit families and couples travelling on any budget.

5.28 Jetstar offers passengers an extensive network within Australia and beyond their Australian gateways. Jetstar's existing arrangements with Qantas, Air France, KLM, Qatar, Emirates and others have seen continued interest in passengers flying via Denpasar and Jakarta.

Strategic Airlines

5.29 Strategic Airlines states that by offering a full-service product in the form of the Airbus A320 aircraft, Strategic Airlines will help ensure that the opportunity for inbound tourism from Indonesia is maximised. The absence of this product offering from any other Australian carrier servicing the Bali market has forced passengers wishing to visit Australia via Denpasar to use a low-cost service, or travel with a foreign airline – both being options that are often unpalatable for passengers in this market.

5.30 Strategic Airlines further considers that, for tourists visiting the region, a holiday to Australia will follow on from a holiday in Bali. Strategic Airlines submits that for many of those passengers, there is a preference to fly business class only. By being able to offer an increased schedule, Strategic Airlines will help ensure that there is no deterrent for these passengers transiting through to Australia who seek a business class offering, and whose preference is to fly with an Australian airline.

Virgin Blue Group

5.31 The Virgin Blue Group submit that it is an established national network carrier with a highly recognisable brand and award winning product and is very well placed to

stimulate increased tourism from Indonesia, including encouraging the significant number of foreign visitors to Indonesia to also visit Australia.

Consumer benefits

Qantas

5.32 Jetstar's differentiated product, efficiency of operations, innovation and extensive route network provides many benefits to Australian consumers. Jetstar notes that in addition to serving point-to-point markets, the Qantas Group also offers connecting services to other major and regional ports in Australia and beyond.

5.33 Jetstar notes it introduced its 'Jetsaver Light Fare' in 2008. This fare gives passengers a \$10 discount on domestic bookings and a \$20 discount on international bookings when passengers travel with only carry-on baggage. Jetstar has increased the maximum carry-on weight to 10 kilograms for all passengers. The initiative provides greater choice to Jetstar's domestic and international customers, allowing them to only pay for services which they value and need, stimulate more demand, and drive greater efficiencies at airports to support the customer service functions around the Jetstar network.

5.34 Jetstar has introduced other initiatives such as boarding passes via SMS. It submits that its Indonesia flights are a popular choice for Qantas' Frequent Flyer members.

5.35 Jetstar distributes its product direct to customers (via its website or call centre), through a series of airlines partners – both via interline and codeshare agreements, through travel agents, tour operators and corporate travel managers.

5.36 In terms of advertising, Jetstar states that no other carrier in Australia puts as much focus on publicity campaigns and the promotion of fares and destinations as Jetstar. In combination with Jetstar's low fares this means Jetstar is uniquely suited to stimulate demand between Australia and Indonesia and ensure the broadest reach of the Australian public that is possible can be achieved.

Strategic Airlines

5.37 Strategic Airlines considers that the presence of three airlines will undoubtedly lead to competition on pricing, which will in turn deliver benefits to the consumer. These benefits may be directly related to fares, the conditions of travel (flexible or otherwise) attached to those fares, or indeed the standard of airline service delivery. Strategic Airlines note it has have proven to be extremely competitive on pricing with its current (limited) schedule. Its market objectives, together with the expectations of passengers, will only be enhanced with the increase in frequency.

5.38 Strategic Airlines submits that consumer choice increases significantly if amongst Australian airlines, there is the option to travel either 'low-cost' or 'full-service', and the choice of travelling economy or business class. Strategic Airlines

submit that this product differentiation obviously opens up options that will appeal to a wider range of consumers.

Virgin Blue Group

5.39 Virgin Blue submits that it has increased consumer benefits in the market by lowering tariffs, increasing choice, and ensuring transparent competition. Virgin Blue further submits it is important that it retain its relative position in the market in order to maintain these consumer benefits.

5.40 Virgin Blue further notes that the Virgin Blue Group offers connections for domestic transfer passengers and for passengers travelling beyond Australia, on the Group's international network. Virgin Blue considers that in assessing consumer benefits, the demonstrable contribution made by the Virgin Blue Group to the development and introduction of competitive pricing, fare restructuring and product development together with its ongoing commitment to capacity growth in this market are important factors.

Trade benefits

Qantas

5.41 Qantas submits that on each of its services to Bali and Jakarta, Jetstar has the ability to move at least 500 kilograms of freight per flight, which will vary depending upon aircraft type, passenger loadings and season of operations.

5.42 Qantas also notes that as part of the Group, Jetstar can offer its freight customers access to an extensive international and domestic network. In addition, Qantas Freight's partnership with Australia Post – Australian Air Express – provides freight and mail services in Australia and offers a seamless transfer between international and domestic networks.

Strategic Airlines

5.43 Strategic Airlines submit that it has a corporate history in contract charter and logistics, with extensive experience in freight and cargo movements. This experience will allow users of air freight services in Australia to have access to the expertise that comes with over 20 years specialising in this part of the aviation industry.

5.44 Further, Strategic Airlines note that with the increase in air freight options through additional flights to Indonesia each week on Strategic Airlines A320, Australian importers and exporters will have access to markedly more competitive freight prices, stimulating multiple industry sectors and the economy at large.

Virgin Blue Group

5.45 Virgin Blue submits that increased capacity provides the opportunity for increased airfreight activity.

Industry structure

Qantas

5.46 Jetstar submits the expansion of its operations to Indonesia will have a positive impact on the development of Australia's aviation industry. Jetstar's planned capacity growth in Indonesia is necessary to meet market requirements and enable Jetstar to remain competitive with foreign airlines on the route.

5.47 Jetstar submits that the significant expansion planned is a substantial step forward for the airline, and an allocation of capacity to Jetstar will help it strengthen its operations in a growing market, making it more robust competitor in Australia's aviation industry and ensure efficient use of its aircraft.

Strategic Airlines

5.48 Strategic Airlines submits that the Australian aviation industry will be stronger from its presence. The opportunity for Strategic Airlines to grow both its revenue and customer base will result in the development of another viable player in the aviation market in Australia. Strategic Airlines notes that it is expected that Indonesia will play a pivotal role in the growth of Strategic Airlines as a business, as public support thus far has been overwhelmingly positive. Further, increased frequency will only serve to support the reputation that Australian carriers have for both quality and service.

Virgin Blue Group

5.49 Virgin Blue submits that its proposed operations will have a positive impact on the Australian aviation industry. Specifically, the operations are an important component of the progressive expansion of its operational network which will bring increased operational efficiency, profitability and more efficient use of aircraft and crews. Further, Virgin Blue submits that the generation of additional profits and operational efficiency within the Virgin Blue Group will have a beneficial effect on the Australian industry.

5.50 Virgin Blue notes that the proposed expansion is fully consistent with a range of decisions taken by successive Australian Governments to facilitate the role played by the Virgin Blue Group in the long term development of the Australian aviation industry.

6 Summary of submissions

Victorian Government

6.1 The Victorian Government supports the applications by Qantas, Strategic Airlines and Virgin Blue for increases in aircraft seating allocation on the Australia – Indonesia route. The Victorian Government believes the currently available capacity of 4,000 seats per week for Australian carriers between Indonesia and Australia is restrictive. It therefore supports an “open skies” agreement between Australia and Indonesia to enable the Australian and Indonesian airlines to determine the frequency of their air services and the routes they wish to best serve growing demand.

Flight Attendants Association of Australia

6.2 The Flight Attendants Association of Australia (FAAA) raised concerns in relation to Pacific Blue Australia's application for capacity. In particular the Association is concerned that while Pacific Blue Australia Pty Limited, is a registered entity owned by the 'Virgin Group', Pacific Blue Airlines Australia is an entity that merely facilitates the operation of New Zealand registered aircraft or aircraft operated by other entities such as the domestic carrier, Virgin Blue.

6.3 The Association notes that Paragraph 5 of the Minister's Policy Statement asks the Commission to assess the applicant, including the extent to which applicants are proposing to provide capacity on aircraft they will operate themselves. In this regard, FAAA notes it is unable to identify Pacific Blue Airlines as either a registered aircraft operator or aircraft registration holder.

6.4 The FAAA is concerned at the recent trend for various entities to seek operational capacity and then utilise such capacity by 'wet leasing' or other entering into other arrangements with suppliers of aircraft and crews. The FAAA argues that under such wet leasing arrangements the intention of public benefit as expressed in the Minister's Policy Statement is significantly compromised, particularly in respect of (potentially) differing safety standards and reduced employment of Australian citizens within the aviation industry.

6.5 The FAAA has recommended that route approvals issued to entities not registered as either an airline operator or the holder of an Australian issued Air Operators Certificate, should be subject to additional conditions that require utilisation of the capacity to be effected using Australian registered aircraft and Australian aircrews. The FAAA requests the Commission to apply greater scrutiny to organisations seeking capacity approval under bilateral provisions where the applicant does not hold valid aircraft registrations or an active AOC.

7 The draft determinations and submissions in response

7.1 The Commission issued draft determinations on 29 September 2010 proposing to allocate 1226 seats of capacity per week in each direction on the Indonesia route, and two frequencies and 369 seats of capacity beyond Indonesia to Qantas, 1514 seats of capacity per week in each direction to Strategic Airlines, and 1260 seats of capacity per week in each direction to Virgin Blue.

7.2 A confidential submission from Qantas was received in response to the draft determinations.

8 Commission's assessment

Introduction

8.1 The start-up provisions of the Minister's policy statement do not apply in this case, as the Commission has previously made determinations allocating passenger capacity to Ansett International, then the initial new entrant at a time when Qantas was an incumbent carrier on the route, thus ending the start-up phase on the Indonesia route.

As there is not sufficient available capacity to satisfy fully the requirements of the three applicants the additional criteria in paragraph 5 of the policy statement are applicable in this case, as well as the paragraph 4 criteria.

Paragraph 4 assessment

8.2 Under paragraph 4, the use of Australian entitlements by a carrier that is reasonably capable of obtaining the necessary approvals (4(b)(i)) and of implementing its proposals (4(b)(ii)) is of benefit to the public.

Qantas

8.3 Qantas and its subsidiary company, Jetstar, are established international carriers which are clearly capable of obtaining the necessary approvals and of implementing the proposed operations.

Strategic Airlines

8.4 Strategic Airlines is now an established international carrier. It already holds allocations of capacity from the Commission for operations on the Indonesia route. Using these allocations, the airline operates regular scheduled services between Perth and Denpasar and between Port Hedland and Denpasar. Strategic Airlines has therefore demonstrated its ability to obtain the necessary approvals and to implement its proposals in relation to operations on the Indonesia route. The Commission is satisfied that Strategic Airlines meets the paragraph 4 criteria.

Virgin Blue Group

8.5 As noted above, the Commission received a submission from the FAAA raising concerns over wet-leasing by Pacific Blue Australia. These issues raised are concerned with the paragraph 4 criteria.

8.6 The Department of Infrastructure and Transport has advised the Commission that the Australian Government's approach to wet-leasing is that, subject to the relevant air services arrangements permitting the use of wet-leased aircraft, airlines should have the flexibility to provide services using aircraft wet-leased from any operator – provided that operator holds all necessary safety and security approvals.

8.7 However, as noted previously, on 13 September 2010, a subsequent application was received from Pacific Blue Australia requesting that its application for capacity on the Indonesia route be considered by the Commission as a request from Virgin Blue Airlines. Given this change in applicant, the concerns raised by the FAAA with regard to wet leasing of aircraft should be alleviated.

8.8 The Commission has previously found Virgin Blue Airlines to meet the paragraph 4 criteria and accordingly allocated capacity to the airline on the Fiji, Vanuatu and New Caledonia routes in 2003. That capacity was later transferred to Pacific Blue Australia. Virgin Blue Airlines is clearly capable of obtaining the necessary approvals and of implementing its proposed operations. The Commission understands that Virgin Blue Airlines has applied to the Department of Infrastructure

and Transport for an international airline licence and to be designated as an Australian international airline under the Australia – Indonesia air services arrangements.

8.9 The Commission is satisfied that Virgin Blue meets the paragraph 4 criteria.

Paragraph 5 assessment

8.10 The Commission’s comparative assessment of the respective proposals against the paragraph 5 criteria in the Minister’s policy statement is set out below. As all three carriers have been found to meet the paragraph 4 criteria, the paragraph 5 criteria are used to assess the comparative merits of the competing applications.

Competition Benefits

The extent to which proposals will contribute to the development of a competitive environment for the provision of international air services. The Commission should have regard to:

- *the need for Australian carriers to be able to compete effectively with one another and the carriers of foreign countries;*
- *the number of Australian carriers on a particular route and the existing distribution of capacity between Australian carriers;*
- *prospects for lower tariffs, increased choice and frequency of service and innovative product differentiation;*
- *the extent to which applications are proposing to provide capacity on aircraft they will operate themselves;*
- *the provisions of any commercial agreement between an applicant and another carrier affecting services on the route but only to the extent of determining comparative competition benefit between competing applications;*
- *any determinations made by the Australian Competition and Consumer Commission or the Australian Competition Tribunal in relation to a carrier using Australian entitlements under a bilateral arrangement on all or part of the route; and*
- *any decisions or notifications made by the Australian Competition and Consumer Commission in relation to a carrier using Australian entitlements under a bilateral arrangement on all or part of the route.*

8.11 As discussed above, the Indonesia route is served by three Australian carriers, all applicants for additional capacity in this case. The following table summarises the existing distribution of capacity between the carriers in terms of seats and percentage share of allocated capacity. Until the recent air services negotiations, the total Australian capacity entitlement was 10,800 seats per week and it is fully allocated between the three applicants as follows:

Airline	Seats allocated per week	Percentage of total seats
Qantas	5,892	54.5%
Strategic Airlines	408	3.8%.
Virgin Blue	4,500	41.7%
TOTAL	10,800	100%

8.12 The following tables set out how each carrier is currently distributing its capacity allocations between each of the four major Australian gateway airports on both a seats and weekly frequency basis.

Qantas

	Brisbane frequency (seats)	Melbourne frequency (seats)	Sydney frequency (seats)	Perth frequency (seats)	Total frequency (seats)
Denpasar	0	4 (1212)	6 (1818)	7 (1239)	17 (4269)
Jakarta	0	0	4 (1188)	2 (354)	6 (1542)
Total	0	4 (1212)	10 (3006)	9 (1593)	23 (5811*)

*81 seats per week are unutilised

Strategic Airlines

	Brisbane frequency (seats)	Melbourne frequency (seats)	Sydney frequency (seats)	Perth frequency (seats)	Total frequency (seats)
Denpasar	0	0	0	3 (468)	3 (468*)

*includes 60 seats approved under the spill-over provisions of the air services arrangements

Virgin Blue Group

	Brisbane frequency (seats)	Melbourne frequency (seats)	Sydney frequency (seats)	Perth frequency (seats)	Total frequency (seats)
Denpasar	7 (1260)	7 (1260)	4 (720)	7 (1260)	25 (4500)

8.13 It is evident from these tables that Strategic Airlines holds a tiny proportion of the capacity allocated between the three applicants. In order for the carrier to provide material competition to the two large and established carriers, it requires the ability to add a significant number of additional capacity and frequencies. Taking these factors together, the Commission considers there is a compelling case to allocate a substantial share of capacity to Strategic Airlines. Doing so would enable Strategic Airlines to compete with a daily frequency in the large Perth market and would allow it to bring important new price, product and service competition to the Melbourne and Sydney markets.

8.14 An important additional public benefit brought by Strategic Airlines is the fact that it is also the only carrier of the three to offer a business class service on the Perth – Denpasar route. Its presence on this route fills an important gap in the current product offerings. The business market values frequency as well as quality of product, and this is a further argument to support a substantial allocation to Strategic Airlines. As Strategic Airlines offers a business class service on all of its services, it will provide increased competition to Jetstar’s ‘Star Class’ business class services on the Sydney and Melbourne sectors.

8.15 The amount of capacity sought by Strategic Airlines’ is less than half that sought by Qantas and several hundred seats fewer than sought by Pacific Blue Australia. The Commission considers that the largest increment in public benefits in this case is likely to be delivered by granting Strategic Airlines most of the capacity it has sought, while providing scope for reasonable capacity increases for both Qantas and Virgin Blue.

8.16 In this respect, the Commission notes that, in contested cases, paragraph 3.5 of the Minister’s Policy Statement requires the Commission to have regard to the objective of providing reasonable growth entitlements to all Australian carriers operating on the route, subject to the provisions of paragraph 5. The Commission considers that there is sufficient capacity available after a substantial allocation to Strategic Airlines to satisfy the requirements of paragraph 3.5, while maximising benefits against the paragraph 5 criteria.

8.17 The Commission considers that a similar quantum of capacity should be allocated to each of Qantas and Virgin Blue. This will facilitate growth by both carriers across a range of sectors and will contribute to a slight shift in overall capacity shares towards Virgin Blue relative to Qantas. Taking account of the allocation to Strategic Airlines also, this will somewhat reduce the substantial capacity share advantage currently held by the Qantas Group.

8.18 In summary, the Commission considers that there is sufficient capacity available to be allocated for the Commission to split the capacity between the three applicants in a way that has regard to the overall balance of capacity as well as other elements of the competition criterion, fostering growth for all carriers, and which is highly likely to generate a higher level of public benefits than could be obtained from an allocation to any one or two carriers only.

8.19 In considering the balance of a split of the capacity against the competition criterion, the factors the Commission needs to weigh up include the relative shares of Australian capacity entitlements and scope for growth, as discussed above, but also: the balance of capacity and frequencies to be operated to achieve the most competitive outcome including in terms of: lower fares in all travel classes; choice and product differentiation; and an efficient allocation of the available capacity, so as to minimise the number of residual and therefore unusable seats.

8.20 The elements of the Other Benefits criterion are also relevant, such as in relation to tourism, freight and industry structure considerations. These are discussed under the respective sub-headings below. However, the competition criteria is the primary one for the Commission to have regard to and, by virtue of the small freight and tourism components on the Indonesia route, is dominant in terms of public benefit considerations in this case.

8.21 In this regard, the Commission considers public benefits are likely to be maximised through the allocation of the available 4000 weekly seats as follows:

Airline	Additional allocation (seats per week)	Total allocation (seats per week)	Percentage of total
Qantas	1226	7118	48.1%
Strategic Airlines	1514	1922*	13.0%
Virgin Blue	1260	5760	38.9%
TOTAL	4000	14800	100%

*plus the currently authorised 60 spill-over seats and a further 46 seats to be sought from aeronautical authorities, making a total of 2028 seats.

8.22 These allocations result in a rebalance of capacity with the Qantas share falling to 48.1% from 54.5%, the Virgin Blue share also declines but by a smaller percentage than Qantas - to 38.9% compared with 41.6% previously, and Strategic Airlines' share increases from 3.7% to 13.0%.

8.23 The Commission has arrived at these total allocations through a notional allocation of seats and frequencies across sectors as set out in the following tables. In the case of Qantas, the allocations facilitate the extra frequencies shown, as well as the increased seat requirements of existing frequencies as aircraft with slightly larger seating capacity are substituted. It also takes account of the 81 unused existing seats allocated to Qantas.

8.24 In the case of Strategic Airlines, the allocation of 1,514 seats is 46 seats less than the airline requires to add the 10 extra frequencies which the Commission will allocate. Strategic would need to seek these extra seats from the Department of Infrastructure and Transport under the spill-over provisions of the air services

arrangements. This would be in addition to the 60 seats it currently has authorised under those arrangements, bringing its total spill-over requirement to 106 seats per week. The air services arrangements make provision for 150 spill-over seats per week.

Qantas

	Brisbane frequency (seats)	Melbourne frequency (seats)	Sydney frequency (seats)	Perth frequency (seats)	Total frequency (seats)
Denpasar	0	0 (28)	1 (352)	3 (561)	4 (941)
Jakarta	0	0	0	2 (366)	2 (366)
Total	0	0 (28)	1 (352)	5 (927)	6 (1226*)

* being 1307 seats, less 81 existing seats currently allocated but unused

Strategic Airlines

	Brisbane frequency (seats)	Melbourne frequency (seats)	Sydney frequency (seats)	Perth frequency (seats)	Total frequency (seats)
Denpasar	0	3 (468)	3 (468)	4 (624)	10 (1514)

Virgin Blue Group

	Brisbane frequency (seats)	Melbourne frequency (seats)	Sydney frequency (seats)	Perth frequency (seats)	Total frequency (seats)
Denpasar	3 (540)	0	1 (180)	3 (540)	7 (1260)

8.25 The above distribution is not intended to be prescriptive as to the way the carriers may actually apply the capacity across the sectors. Rather, it has been derived on the basis of facilitating expansion by each carrier in a way which the Commission believes would foster the greatest competition gains and delivers scope for expansion on all city pairs. This means that travellers to and from all of the four major Australian gateways would have additional capacity available to them and a choice of a new carrier in the case of Sydney and Melbourne. The Commission has made notional provision for Strategic Airlines to introduce three services per week from each of these gateways – a total of six frequencies compared with the seven per week sought by the airline.

8.26 The Commission has authority under the Minister’s policy statement to specify the points which must be served by carriers. However, it will not do so in this case because growth by sector may not be uniform and to do so would remove the flexibility for airlines to implement services on particular sectors based on their particular commercial considerations.

8.27 In making the notional distribution between points, priority has been given to expansion at Perth, which is the largest segment of the market. In particular this includes scope for an increase from three per week to daily frequencies for Strategic Airlines, as well as extra flights for both Virgin Blue and Jetstar (to both Denpasar and Jakarta). The Commission notes that the Perth market is in high demand, with the Denpasar-Perth route the tenth largest city pair for uplift/discharge of international passengers to and from Australia.

8.28 The allocation to Qantas is only a little over a third of the very large allocation which it sought. However, the notional allocations enable Jetstar to add services on both the Perth (to Denpasar and Jakarta) and Sydney (Denpasar only) sectors, but with less frequency than it planned. No provision is made for expansion at Melbourne (three weekly frequencies were planned), but the allocation to Strategic Airlines will enable that market to continue growing.

8.29 In the allocation to Qantas, the Commission has recognised that the Qantas Group is the only airline which is operating to Jakarta, offering services from both Sydney (Qantas) and Perth (Jetstar). It has therefore made provision for expansion on the Perth – Jakarta sector with a notional increase of two frequencies per week compared with the extra five per week sought. Qantas did not propose to add Sydney – Jakarta frequencies. The Commission recognises that this restriction will mean that Qantas would not be able to add all of the extra services beyond Jakarta to Singapore as it proposed. The Commission therefore proposes to allocate beyond capacity of two frequencies and 369 seats per week beyond Jakarta.

8.30 As noted above, in terms of product differentiation, Strategic Airlines is the only airline of the three applicants which offers business class on all of its services to Denpasar, and is the only airline to offer business class on the Perth – Denpasar route. Jetstar offers its ‘Star Class’ business class service on its services from Sydney and Melbourne. To enable Strategic to compete effectively against Jetstar and Virgin Blue, the allocations suggested above, will enable Strategic to offer daily services from Perth – Denpasar. Significantly, Strategic will be able to enter the Sydney - Denpasar and Melbourne – Denpasar sectors where it has previously not operated services. This will increase the levels of competition and product offerings on these routes.

8.31 Virgin Blue is the only airline of the three which is operating services from Brisbane. The Commission has made provision for the extra three weekly flights from Brisbane sought by Virgin Blue to facilitate growth at that point. The notional sector allocations to Virgin Blue on the Sydney and Perth sectors will enable it to increase services, but not to the extent it proposed. Virgin Blue did not propose any increase in its services between Melbourne and Denpasar.

8.32 The Commission has had regard to the commencement date for which the extra capacity will be utilised on the routes. This is because the sooner capacity is operated, the more quickly public benefits will be delivered. Strategic has indicated it is looking to commence additional services from December 2010 with the capacity fully utilised by 31 October 2011. In the same way, Qantas plans to introduce additional services between Australia and Indonesia from December 2010 and to fully utilise the capacity by 31 October 2011. Virgin Blue on the other hand has not indicated a start date for the

additional services, other than stating that the capacity will be fully utilised by 31 October 2011. However, the Commission anticipates that Virgin Blue would phase in capacity over the period until 31 October 2011. While there may be some differences with the timing of implementation between the carriers, the Commission considers there is not sufficient difference to warrant a rebalancing of the allocations, as proposed, in favour of one carrier which might implement capacity more quickly than others.

8.33 The Commission notes that under this criteria, it is required to take into account the extent to which the applicants are proposing to provide capacity on aircraft they operate themselves. As noted under the Commission's consideration of the paragraph 4 criteria, Pacific Blue Australia has asked the Commission to consider its application to be from Virgin Blue Airlines, which means the capacity allocated to Virgin Blue will be provided on aircraft they operate themselves. Both Strategic and Jetstar provide the capacity on aircraft they operate themselves.

8.34 In relation to future capacity requirements for Australian carriers, the Commission understands that there was an undertaking by the aeronautical authorities to meet again within six months to discuss the air services arrangements. However, as the outcome of any negotiations cannot be prejudged, the Commission has not taken this into consideration in its decision making process. Should additional capacity entitlements be settled, this could open the way for the full requirements of all three applicants to be satisfied.

Other benefits

Tourism benefits

(b) In assessing the extent to which applications will promote tourism to and within Australia, the Commission should have regard to:

- The level of promotion, market development and investment proposed by each of the applicants; and*
- route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s).*

8.35 Inbound tourism has increased on the route by over 19% in the past year, however, resident departures account for over 80% of travel on the route. In terms of serving beyond gateways, Jetstar is growing its services looking to offer same-day connectivity to over 25 cities, including four in New Zealand. Jetstar will also be offering services beyond Jakarta to Singapore. The Commission considers that all three carriers will promote Australia as a destination in the Indonesia market.

8.36 The Commission considers the Qantas proposal offers slightly greater benefits against this criterion. However the Commission attaches only modest weighting to the criterion given the route has not a great amount of tourist traffic to Australia.

8.37 *Consumer Benefits*

(c) In assessing the extent to which the applications will maximise benefits to Australian consumers, the Commission should have regard to:

- *the degree of choice (including, for example, choice of airport(s), seat availability, range of product);*
- *efficiencies achieved as reflected in lower tariffs and improved standards of service;*
- *the stimulation of innovation on the part of incumbent carriers; and*
- *route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s).*

8.38 Most of the elements of this criterion have been discussed in the context of competition benefits above. As noted, the Commission considers the greatest competition benefits will be achieved by the operation of all three carriers on the route. The same is true for consumer benefits as all three operators will result in greater consumer choice, by way of product choice and route choice. Strategic Airlines offers a business class service. Jetstar offers its ‘Star Class’ business class service on its services from Sydney and Melbourne. Jetstar and Virgin Blue also give consumers flexibility to purchase additional onboard options. The increases in capacity will enable carriers to increase their service offerings, through increases in frequency and choice with Strategic Airlines proposing to operate services from Sydney and Melbourne. Virgin Blue remains the only carrier operating services from Brisbane to Denpasar, whilst Jetstar is the only carrier providing services to Jakarta.

Trade Benefits

(d) In assessing the extent to which applications will promote international trade, the Commission should have regard to:

- *the availability of frequent, low cost, reliable freight movement for Australian exporters and importers.*

8.39 All three applicants can operate limited freight through the use of the aircraft belly hold. Qantas’ operations are likely to offer the greatest benefit against this criterion, given its extensive international and domestic network and partnership with Australia Post – Australian air Express. However, there is little else to discriminate between the three carriers and cargo carriage is minor relative to passenger demand.

Industry Structure

(e) The Commission should assess the extent to which applications will impact positively on the Australian aviation industry.

8.40 The Commission considers that all three proposals will have a positive impact on the Australian aviation industry. However, the Commission considers that the public benefits are potentially higher in the case of Strategic Airlines, given it is expanding its operations and will be able to provide more effective competition to Qantas and Virgin Blue.

Conclusion

8.41 The Commission considers that Qantas, Strategic Airlines and Virgin Blue are reasonably capable of obtaining the necessary approvals and of implementing their proposals, and therefore meet the paragraph 4 criteria. The Minister's policy statement makes it clear that use of capacity by Australian carriers which meet paragraph 4 is of benefit to the public.

8.42 Under paragraph 5.2 of the Minister's policy statement, in applying all criteria, the Commission should take as the pre-eminent consideration the competition benefits of each application. The Commission considers that all three proposals bring strong competition benefits, but there are clearly greater competitive benefits likely to be associated with the splitting of capacity in the way proposed. The capacity splitting will result in a rebalancing of the share of capacity, and will see greater frequency and capacity operated. This should further intensify price competition to fill seats.

9 Determination allocating capacity on the Indonesia route to Qantas Airways Ltd (Qantas) ([2010] IASC 107)

9.1 The Commission makes a determination in favour of Qantas, allocating 1226 seats of capacity per week in each direction on the Indonesia route, and two frequencies and 369 seats of passenger capacity beyond Indonesia, neither of which may serve Denpasar, in accordance with the Australia – Indonesia air services arrangements.

9.2 The determination is for three years from the date of the determination.

9.3 The determination is subject to the following conditions:

- Qantas is required to fully utilise the capacity from no later than 31 October 2011 or from such other date approved by the Commission;
- only Qantas or another Australian carrier which is a wholly-owned subsidiary of Qantas is permitted to utilise the capacity;
- Qantas is not permitted to utilise the capacity to provide services jointly with another Australian carrier or any other person without the prior approval of the Commission;
- the capacity may be used by any wholly-owned subsidiary of Qantas to provide joint services with Qantas;
- to the extent that the capacity is used to provide joint services on the route, Qantas and any wholly-owned subsidiary of Qantas must take all reasonable steps to ensure that passengers are informed of the carrier actually operating the flight at the time of booking;
- changes in relation to the ownership and control of Qantas are permitted except to the extent that any change:

- results in the designation of the airline as an Australian carrier under the Australia – Indonesia air services arrangements being withdrawn; or
 - has the effect that another Australian carrier, or a person (or group of persons) having substantial ownership or effective control of another Australian carrier, would take substantial ownership of Qantas or be in a position to exercise effective control of Qantas, without the prior consent of the Commission; and
- changes in relation to the management, status or location of operations and head office of Qantas are permitted except to the extent that any change would result in the airline ceasing to be an airline designated by the Australian Government for the purposes of the Australia – Indonesia air services arrangements

10 Determination allocating capacity on the Indonesia route to Strategic Airlines Pty Ltd (Strategic Airlines) ([2010] IASC 108)

10.1 The Commission makes a determination in favour of Strategic Airlines allocating 1514 seats of capacity per week in each direction on the Indonesia route, in accordance with the Australia – Indonesia air services arrangements.

10.2 The determination is for three years from the date of the determination.

10.3 The determination is subject to the following conditions:

- Strategic Airlines is required to fully utilise the capacity from no later than 31 October 2011 or from such other date approved by the Commission;
- only Strategic Airlines is permitted to utilise the capacity;
- Strategic Airlines is not permitted to utilise the capacity to provide services jointly with another Australian carrier or any other person without the approval of the Commission;
- changes in relation to the ownership and control of Strategic Airlines are permitted except to the extent that any change:
 - results in the designation of the airline as an Australian carrier under the Australia – Indonesia air services arrangements being withdrawn; or
 - has the effect that another Australian carrier, or a person (or group of persons) having substantial ownership or effective control of another Australian carrier, would take substantial ownership of Strategic Airlines or be in a position to exercise effective control of

Strategic Airlines, without the prior consent of the Commission;
and

- changes in relation to the management, status or location of operations and head office of Strategic Airlines are permitted except to the extent that any change would result in the airline ceasing to be an airline designated by the Australian Government for the purposes of the Australia – Indonesia air services arrangements.

11 Determination allocating capacity on the Indonesia route to Virgin Blue Airlines Pty Ltd (Virgin Blue) ([2010] IASC 109)

11.1 The Commission makes a determination in favour of Virgin Blue allocating 1260 seats of capacity per week in each direction on the Indonesia route, in accordance with the Australia – Indonesia air services arrangements.

11.2 The determination is for three years from the date of the determination.

11.3 The determination is subject to the following conditions:

- Virgin Blue is required to fully utilise the capacity from no later than 31 October 2011 or from such other date approved by the Commission;
- only Virgin Blue is permitted to utilise the capacity;
- Virgin Blue is not permitted to utilise the capacity to provide services jointly with another Australian carrier or any other person without the approval of the Commission;
- changes in relation to the ownership and control of Virgin Blue are permitted except to the extent that any change:
 - results in the designation of the airline as an Australian carrier under the Australia – Indonesia air services arrangements being withdrawn; or
 - has the effect that another Australian carrier, or a person (or group of persons) having substantial ownership or effective control of another Australian carrier, would take substantial ownership of Virgin Blue or be in a position to exercise effective control of Virgin Blue, without the prior consent of the Commission; and
- changes in relation to the management, status or location of operations and head office of Virgin Blue are permitted except to the extent that any change would result in the airline ceasing to be an airline designated by the Australian Government for the purposes of the Australia – Indonesia air services arrangements.

Dated: 25 October 2010

Ian Smith
Member Presiding

Stephen Bartos
Member